

REPORT OF EXAMINATION  
OF  
COMPWEST INSURANCE COMPANY

AS OF  
DECEMBER 31, 2009

Participating State  
and Zone:

California

Filed December 28, 2010

## TABLE OF CONTENTS

	<u>PAGE</u>
SCOPE OF EXAMINATION .....	1
COMPANY HISTORY .....	2
CORPORATE RECORDS .....	2
MANAGEMENT AND CONTROL: .....	2
Intercompany Agreements .....	5
TERRITORY AND PLAN OF OPERATION .....	7
REINSURANCE: .....	7
Assumed .....	7
Ceded .....	7
FINANCIAL STATEMENTS: .....	9
Statement of Financial Condition as of December 31, 2009 .....	10
Underwriting and Investment Exhibit for the Year Ended December 31, 2009 .....	11
Reconciliation of Surplus as Regards Policyholders from December 31, 2006 through December 31, 2009 .....	12
COMMENTS ON FINANCIAL STATEMENT ITEMS: .....	13
Losses and Loss Adjustment Expenses .....	13
SUMMARY OF COMMENTS AND RECOMMENDATIONS: .....	13
Current Report of Examination .....	13
Previous Report of Examination .....	13
ACKNOWLEDGEMENT .....	14

San Francisco, California  
November 5, 2010

Honorable Alfred W. Gross  
Chairman of the NAIC Financial  
Condition Subcommittee  
Commissioner of Insurance  
Virginia Bureau of Insurance  
Richmond, Virginia

Honorable Christina Urias  
Secretary, Zone IV-Western  
Director of Insurance  
Arizona Department of Insurance  
Phoenix, Arizona

Honorable Steve Poizner  
Insurance Commissioner  
California Department of Insurance  
Sacramento, California

Dear Chairman, Secretary and Commissioner:

Pursuant to your instructions, an examination was made of the

#### COMPWEST INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 301 Howard Street, Suite 1700, San Francisco, California 94105.

#### SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2006. This examination covers the period from January 1, 2007 through December 31, 2009. The examination was conducted pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions, and an evaluation of assets and a determination of liabilities as of December 31, 2009, as deemed necessary under the circumstances. A concurrent examination was conducted by the Michigan Office of Financial and Insurance

Regulation of the Company's upstream affiliates Accident Fund Insurance Company of America, Accident Fund General Insurance Company and Accident Fund National Insurance Company. Efforts were made to coordinate with Michigan as deemed appropriate. In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; accounts and records; and sales and advertising.

### COMPANY HISTORY

The Company's Articles of Incorporation were amended in June and December 2009 to increase the par value of its common stock to a total of \$300 per share. There were 10,000 shares of common stock outstanding. This raised the common capital stock from \$1 million to \$3 million, and decreased unassigned funds accordingly. The changes were made to satisfy minimum capital requirements in Alaska and Texas. No dividends were paid during the examination period.

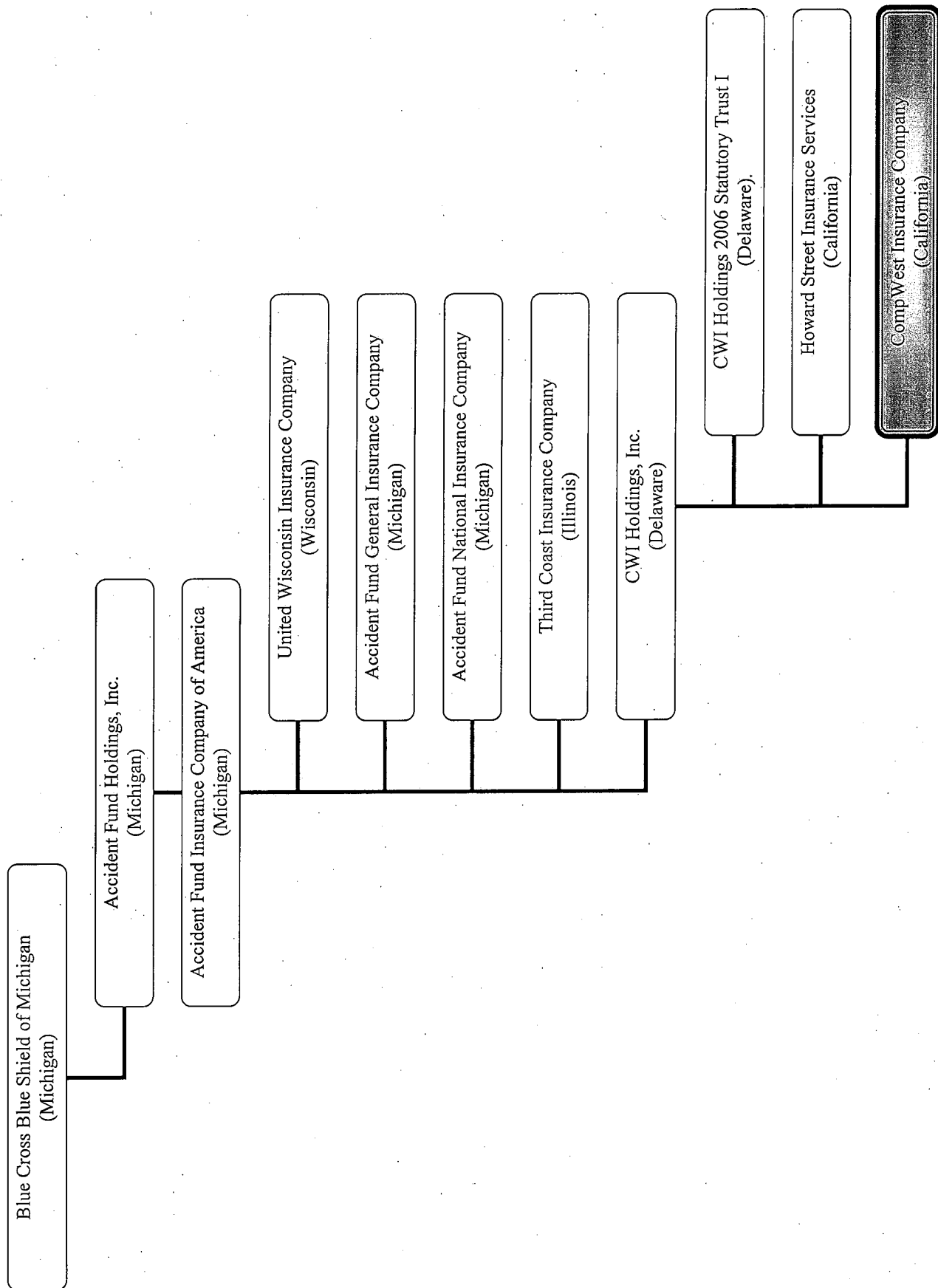
### CORPORATE RECORDS

The Company was not in compliance with California Insurance Code (CIC) Section 735, which requires the Company to inform the board of directors at its next regularly scheduled meeting of every examination report received from the California Department of Insurance. It is recommended the Company comply with CIC Section 735 and inform its board of such receipt.

### MANAGEMENT AND CONTROL

The Company is directly owned by CWI Holdings, Inc., which also owns Howard Street Insurance Services (HSIS) and CWI Holdings 2006 Statutory Trust I (the Trust). As of December 31, 2009, there have been no transactions between the Company and either HSIS or the Trust. The Company became part of a new holding company system effective November 20, 2007 through the acquisition

of CWI Holdings, Inc. by Accident Fund Insurance Company of America, a Michigan property and casualty insurer, which is wholly-owned by Blue Cross Blue Shield of Michigan. The following chart shows the members of the holding company as of December 31, 2009. Ownership is 100% unless otherwise indicated.



The Company is managed by a four-member board of directors, elected annually. The directors and principal officers serving as of December 31, 2009 were as follows:

#### Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Elizabeth R. Haar Howell, Michigan	President and Chief Executive Officer Accident Fund Insurance Company of America
William J. Mudge IV San Francisco, California	President and Chief Executive Officer CompWest Insurance Company
Stephen C. Pogue San Francisco, California	Secretary and Chief Operating Officer CompWest Insurance Company
Ronald H. Schoen Okemos, Michigan	Executive Vice President and Chief Financial Officer Accident Fund Insurance Company of America

#### Principal Officers

<u>Name</u>	<u>Title</u>
William J. Mudge IV	President and Chief Executive Officer
Stephen C. Pogue	Secretary and Chief Operating Officer
Patrick J. Persse	Treasurer and Chief Financial Officer
Ronald D. Field	Chief Medical and Disability Officer
Kenneth R. Van Laar, Jr., FCAS, MAAA	Chief Underwriting Officer

#### Intercompany Agreements

The Company was party to the following intercompany agreements at December 31, 2009:

Intercompany Services Agreement – This agreement was effective August 28, 2008 between Blue Cross Blue Shield of Michigan (BCBSM) and Accident Fund Insurance Company of America

(AFICA) and subsidiaries, including the Company. The agreement calls for BCBSM to provide the following services to its subsidiaries: investment management; financial reporting; tax compliance; treasury services and other administrative and facilities services. The Company paid BCBSM \$40,197 for these services in 2009. The agreement was approved by the California Department of Insurance (CDI) on August 19, 2008.

**Tax Sharing Agreement** – This agreement was effective November 20, 2007 between AFICA and CWI Holdings, Inc. and its subsidiaries. The agreement calls for income tax liability to be settled between the parties based on separate return calculations. Current credit is given for net losses, with payments due 30 days after the consolidated return is filed. The agreement was approved by the CDI on February 14, 2008.

**Net Retained Liability Quota Share Reinsurance Contract** – This agreement was effective January 1, 2008 between AFICA and the Company. Part A of this agreement calls for the Company to cede 90% of premiums, losses, loss adjustment expenses, and other underwriting expenses to AFICA. In Part B of the agreement, total loss and loss adjustment expenses incurred in excess of \$85 million for policies written prior to January 1, 2008 are ceded by the Company to AFICA. The agreement was approved by the CDI on December 27, 2007.

**Services Agreement** – This agreement was effective November 23, 2009 between the Company and Howard Street Insurance Services (HSIS), the Company's affiliate and licensed California agent. The agreement calls for the Company to provide administrative support, services and facilities, as needed, including financial reporting, tax compliance, treasury services, and other general services. No services were provided during the examination period. The agreement was approved by the CDI on November 19, 2009.

**General Agency Agreement** – This agreement between the Company and HSIS, which has not yet been executed, was approved by the CDI on October 29, 2009. The agreement calls for HSIS to act as agent for the Company for the production of business.



## TERRITORY AND PLAN OF OPERATION

The Company was licensed to write disability, liability and workers' compensation in California. Its target market is workers' compensation insurance for mid-sized businesses in low to mid-hazard classes of business. Direct written premium was \$111 million in 2009 and was concentrated in California (98%). Other states in which the Company was licensed as of December 31, 2009 were: Arizona, Colorado, Idaho, Nevada, Oregon, and Utah. Business is produced through a network of 42 independent producers.

## REINSURANCE

### Assumed

The Company assumed no reinsurance other than its proportional share of the mandatory National Workers Compensation Reinsurance Association pool, which was minimal.

### Ceded

Following is a summary of the principal ceded reinsurance treaties inforce as of December 31, 2009:

Type of Contract	Reinsurers All authorized except as noted by (U)	Company Retention	Reinsurer's Limits
Workers' Compensation Excess of Loss	Hannover Ruckversicherung AG	20.00%	<u>1<sup>st</sup> Layer:</u>
	Safety National Casualty Corporation	23.75%	<u>1<sup>st</sup> Layer:</u>
	Paris Re (U)	18.75%	\$1.5 million
	Lloyd's Syndicates (five total)	<u>37.50%</u>	\$3.5 million
		100.00%	
	Hannover Ruckversicherung AG	22.50%	<u>2<sup>nd</sup> Layer:</u>
	Partner Reinsurance Company of the U.S.	2.50%	<u>2<sup>nd</sup> Layer:</u>
	Paris Re (U)	20.25%	\$5 million
	Lloyd's Syndicates (six total)	<u>54.75%</u>	\$5 million
		100.00%	

Type of Contract	Reinsurers All authorized except as noted by (U)	Company Retention	Reinsurer's Limits
Workers' Compensation Catastrophe Excess of Loss	Munich Re America 20.00% Odyssey America Reinsurance Corporation 12.50% Axis Specialty Limited (U) 20.00% Endurance Specialty Ins. Ltd. (U) 17.50% Tokio Millennium Reinsurance Ltd. (U) 15.00% Hannover Ruckversicherung AG 5.00% Lloyd's Syndicate (one total) 10.00% 100.00%	<u>1<sup>st</sup> Layer:</u> \$10 million	<u>1<sup>st</sup> Layer:</u> \$10 million
	Arch Reinsurance Company 7.50% Munich Re America 15.00% Odyssey America Reinsurance Corporation 5.00% Axis Specialty Limited (U) 10.00% Endurance Specialty Ins. Ltd. (U) 10.00% Tokio Millennium Reinsurance Ltd. (U) 10.00% Validus Reinsurance, Ltd. (U) 7.50% Hannover Ruckversicherung AG 5.00% Lloyd's Syndicates (four total) 30.00% 100.00%	<u>2<sup>nd</sup> Layer:</u> \$20 million	<u>2<sup>nd</sup> Layer:</u> \$30 million
	Arch Reinsurance Company 5.50% Munich Re America 12.50% Odyssey America Reinsurance Corporation 4.50% Axis Specialty Limited (U) 12.50% Endurance Specialty Ins. Ltd. (U) 12.50% Hannover Re (Bermuda) Ltd. (U) 5.00% Tokio Millennium Reinsurance Ltd. (U) 10.00% Validus Reinsurance, Ltd. (U) 5.00% Lloyd's Syndicates (five total) 32.50% 100.00%	<u>3<sup>rd</sup> Layer:</u> \$50 million	<u>3<sup>rd</sup> Layer:</u> \$50 million

Type of Contract	Reinsurers All authorized except as noted by (U)	Company Retention	Reinsurer's Limits
Net Retained Liability Quota Share Reinsurance Contract	Accident Fund Insurance Company of America (Affiliate)	<u>Part A:</u> 10% of premiums, losses, and expenses incurred on or after January 1, 2008.	<u>Part A:</u> 90% of premiums, losses, and expenses incurred on or after January 1, 2008.
		<u>Part B:</u> 10% of the loss and loss adjustment expenses incurred as of December 31, 2007 on policies written prior to January 1, 2008, subject to a Company retention of \$85 million.	<u>Part B:</u> 90% of the loss and loss adjustment expenses incurred as of December 31, 2007 on policies written prior to January 1, 2008, excess of the \$85 million Company retention.

### FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2009

Underwriting and Investment Exhibit for the Year Ended December 31, 2009

Reconciliation of Surplus as Regards Policyholders from December 31, 2006 through December 31, 2009

Statement of Financial Condition  
as of December 31, 2009

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Nonadmitted Assets</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 214,149,652	\$	\$ 214,149,652	
Cash and short-term investments	6,272,004		6,272,004	
Investment income due and accrued	2,832,557		2,832,557	
Premiums and considerations:				
Uncollected premiums and agents' balances in the course of collection	(469,102)	23,216	(492,318)	
Deferred premiums, agents' balances and installments booked but deferred and not yet due (EBUB)	3,440,000	344,000	3,096,000	
Reinsurance:				
Other amounts receivable under reinsurance contracts	1,840		1,840	
Net deferred tax asset	4,695,053	2,962,756	1,732,297	
Guaranty funds receivable or on deposit	6,407,903		6,407,903	
Electronic data processing equipment and software	2,995,615	2,276,885	718,730	
Furniture and equipment	208,421	208,421		
Receivables from parent, subsidiaries and affiliates	6,539		6,539	
Aggregate write-ins for other than invested assets	<u>2,633,116</u>	<u>1,163,357</u>	<u>1,469,759</u>	
Total assets	\$ <u>243,173,598</u>	\$ <u>6,978,635</u>	\$ <u>236,194,963</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Losses		\$	29,926,116	(1)
Loss adjustment expenses			5,892,721	(1)
Commissions payable			789,845	
Other expenses			3,251,545	
Taxes, licenses and fees			76,240	
Current federal and foreign income taxes			4,269,053	
Unearned premiums			548,434	
Advance premiums			2,558,048	
Funds held by company under reinsurance treaties			89,174,608	
Amounts withheld or retained by company for account of others			6,984,904	
Provision for reinsurance			57,303	
Payable to parent, subsidiaries, and affiliates			<u>180,284</u>	
Total liabilities			143,709,101	
Common capital stock	\$	3,000,000		
Gross paid-in and contributed surplus		47,000,000		
Unassigned funds (surplus)		<u>42,485,863</u>		
Surplus as regards policyholders			<u>92,485,862</u>	
Total liabilities, surplus and other funds			\$ <u>236,194,963</u>	

Underwriting and Investment Exhibit  
for the Year Ended December 31, 2009

Statement of Income

Underwriting Income

Premiums earned		\$ 10,696,540
Deductions:		
Losses incurred	\$ 7,512,892	
Loss expenses incurred	1,876,248	
Other underwriting expenses incurred	3,054,292	
Aggregate write-ins for underwriting deductions	<u>17,657</u>	
Total underwriting deductions		<u>12,461,089</u>
Net underwriting loss		(1,764,549)

Investment Income

Net investment income earned	\$ 8,047,600	
Net realized capital gains	<u>3,601,437</u>	
Net investment gain		11,649,037

Other Income

Net loss from agents' balances charged off	(141,741)	
Finance and service charges not included in premiums	<u>\$ 8,250</u>	
Total other income		<u>(133,491)</u>
Net income before federal income taxes		9,750,997
Federal income taxes incurred		<u>2,148,244</u>
Net income		<u>\$ 7,602,753</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2008		\$ 86,236,564
Net income	\$ 7,602,753	
Change in net deferred income tax	(599,567)	
Change in nonadmitted assets	(693,878)	
Change in provision for reinsurance	(57,302)	
Capital changes:		
Paid in	2,000,000	
Surplus adjustments:		
Paid in	(2,000,000)	
Aggregate write-ins for losses in surplus	<u>(2,708)</u>	
Change in surplus as regards policyholders for the year		<u>6,249,298</u>
Surplus as regards policyholders, December 31, 2009		<u>\$ 92,485,862</u>

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2006 through December 31, 2009

Surplus as regards policyholders,  
 December 31, 2006, per Examination \$ 57,722,053

	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 38,196,655	\$	
Change in net deferred income tax		1,882,257	
Change in nonadmitted assets		2,497,806	
Change in provision for reinsurance		57,302	
Capital paid in	2,000,000		
Surplus paid in		2,000,000	
Aggregate write-ins for gains in surplus	<u>1,004,519</u>		
Total gains and losses	\$ <u>41,201,174</u>	\$ <u>6,437,365</u>	
Net increase in surplus as regards policyholders			<u>34,763,809</u>
Surplus as regards policyholders, December 31, 2009, per Examination			\$ <u>92,485,862</u>

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Losses and Loss Adjustment Expenses

Based on an analysis by a Senior Casualty Actuary for the California Department of Insurance, the Company's loss and loss adjustment expense reserves as of December 31, 2009 were found to be reasonably stated and have been accepted for purposes of this examination.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Corporate Records - (Page 2): It was noted that the Company was not in compliance with California Insurance Code (CIC) Section 735, which requires the Company to inform the board of directors at its next regularly scheduled meeting of every examination report received from the California Department of Insurance. It is recommended the Company comply with CIC Section 735.

### Previous Report of Examination

Accounts and Records (Page 12): It was recommended the Company review the recommendations made regarding its information systems and make appropriate changes to strengthen its controls. The Company has adopted this recommendation.

Bonds and Stocks (Page 12): It was recommended the Company deposit its securities with a qualified custodian pursuant to California Insurance Code Section 1104.9. The Company has adopted this recommendation.

### ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination is gratefully acknowledged.

Respectfully submitted,

\_\_\_\_\_/s/\_\_\_\_\_

Isabel Spiker, CFE  
Examiner-In-Charge  
Senior Insurance Examiner  
Department of Insurance  
State of California